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January 10, 2006

To: Mayor Michael D. Antonovich
Supervisor Gloria Molina
Supervisor Yvonne B. Burke
Supervisor Zev Yaroslavsky
Supervisor Don Knabe

From: David E. Janssen
Chief Administrative Officer

SACRAMENTO UPDATE -- GOVERNOR'S PROPOSED FY 2006-07 BUDGET

Today, Governor Schwarzenegger released his \$125.6 billion Proposed Budget for FY 2006-07. The Budget proposes \$91.6 billion in revenues and expenditures of \$97.9 billion. This shortfall is offset by the use of the \$6.5 billion reserve that is projected through the end of FY 2005-06, leaving a \$674 million year end reserve in FY 2006-07. The Proposed Budget reflects available resources of \$1.15 billion more than was estimated by the Legislative Analyst's Office (LAO) in November 2005.

The impact of the Proposed Budget on the County appears to be substantially less than in FY 2005-06. Last year's budget proposal would have reduced funding for IHSS provider wages, juvenile probation camps, juvenile justice prevention, and transportation funding pursuant to Proposition 42, and suspended funding for mandates. The FY 2006-07 Proposed Budget supports funding for these programs, and it also provides funding for the continuation of Proposition 36, and booking fee subventions. It does not address the statewide restoration of the Property Tax Administration Program. The Proposed Budget also would reduce funding for CalWORKs Administration. We are working with the departments to estimate the impact of these items. In addition, it is important to note that the Proposed Budget does not address California's response to Federal budget reductions in health and social services programs that are likely to be enacted.

The Proposed Budget General Fund expenditures of \$97.9 billion represents an 8.4 percent increase over expenditures in the current year. This compares to an estimated 4.9 percent growth in available General Fund resources for FY 2006-07. The major contributors to General Fund revenue are personal income taxes and sales and use taxes which are expected to increase in the budget year by 7.1 percent and 4.1 percent, respectively. The increase in the rate of expenditures appears to exceed the rate of increase in revenues under the Administration's plan. Last year, the Administration acknowledged a \$9.1 billion funding gap between revenues and expenditures as part of an ongoing structural imbalance. In November, the LAO identified an ongoing shortfall of \$4 billion that would be gradually reduced by future increases in revenue. At this time, it is not known how the Proposed Budget would impact the structural deficiencies in future years.

The Governor also proposes a "Strategic Growth Program" for infrastructure improvement in the amount of \$222 billion over a ten-year period. The program is divided into two five-year plans and would include improvements in the areas of transportation, air quality, K-12 schools, higher education, flood control, water supply, public safety, and the courts. In total, according to the Administration, \$68 billion of the projects would be funded through General Obligation bonds, existing revenue streams would make up \$100.8 billion, and \$53 billion of additional revenues would need to be identified. The Speaker indicated that the plan must be completed by the end of January in order to place the issue before the voters as part of the June 2006 ballot.

The Proposed Budget's key economic indicators – California personal income, taxable sales and consumer price index – are similar to the LAO's November 2005 Fiscal Outlook. The LAO will issue its overview of the Governor's Proposed Budget this week. In February, the LAO will release its analysis of the Governor's Proposal, at which point the Legislature will evaluate the economic assumptions underlying the revenue forecast and the spending projections that, together, determine the size of the budget gap. The Administration will update its economic forecast as part of the May Revision.

BUDGET HIGHLIGHTS

Based on a preliminary analysis of the "Governor's Budget Summary," the following is a summary of County-interest proposals:

General Government

SB 90 State Mandated Local Programs. Includes \$98.1 million for the first year of the 15-year repayment plan to reimburse counties for mandated costs incurred prior to FY 2004-05. Of this initial amount, the County will receive approximately

\$14 million. The State currently owes the County about \$197.4 million for mandate claims prior to FY 2004-05.

Property Tax Administration Grant Program (PTAP). Extends the suspension of the State-County Property Tax Administration Program through FY 2006-07. This action would result in an additional \$13.5 million loss of revenue to the County. The Administration indicated that it is willing to work with the Legislature and local government representatives to create a new PTAP program for implementation in FY 2007-08.

California State Library. Proposes \$74.6 million, a \$990,000 increase from FY 2005-06 with status quo funding levels for the Public Library Foundation program and the English Acquisition and Literacy Program.

Food and Agriculture. Proposes \$285 million including an increase of \$12.6 million above the FY 2005-06 Budget, for the prevention or eradication of animal diseases and invasive species. Additionally, it includes \$7.2 million for programs to address emerging threats to the State's food supply.

Health

Medi-Cal. Expenditures are estimated to be \$33.8 billion in FY 2006-07 (\$13.2 billion General Fund) an increase of 12.8 percent above FY 2005-06 expenditures.

Medi-Cal Managed Care Expansion.

- **Seniors and Persons with Disabilities.** Includes \$2 million (\$936,000 General Fund) to expand outreach and education efforts in Medi-Cal managed care counties to increase voluntary enrollment. The Proposed Budget further proposes to require mandatory enrollment of this population in two additional counties beginning in April 2008.
- **Serious Mental Illness and Chronic Medical Conditions.** Includes \$473,000 (\$208,000 General Fund) to create demonstration projects to coordinate care, including primary care and disease management, for Medi-Cal beneficiaries who have serious mental illness and chronic health conditions and for those with chronic conditions who are seriously/terminally ill.

Medi-Cal County Administration Cost Control. Proposes to freeze the State's contribution to county overhead and salaries at the FY 2005-06 level for a savings of \$42.4 million (\$21.2 million General Fund). This proposal is intended

to help control the cost of county administration, one of the fastest growing components of the Medi-Cal program.

Expanding Health Insurance Coverage for Children. Includes \$72.2 million to enroll 400,000 children who are eligible but not enrolled in the Medi-Cal and Healthy Families Programs, including up to \$20 million in grants to counties for outreach and enrollment activities, and \$45.5 million to simplify the annual redetermination eligibility form for children who are already enrolled in Medi-Cal.

Public Health. Increases funding by \$49 million (\$47.3 million General Fund) to bolster State and local public health capacity to prevent and respond to disease outbreaks and natural or man-made disasters.

Hospital Financing Waiver. Reflects an additional \$246 million in Federal funding for hospitals under the new Federal Hospital Financing Waiver in FY 2005-06 and \$570.7 million in FY 2006-07.

Proposition 36. Proposes to fund Proposition 36, the Substance Abuse and Crime Prevention Act of 2000, at \$120 million on a one-time basis conditioned upon the Legislature passing reforms to the program. Proposed reforms include jail sanctions to hold offenders accountable for attending and completing treatment, mandatory drug testing as a condition of probation, and judicial monitoring using the drug court model. It should be noted that the LAO reports that in FY 2004-05 actual expenditures for Proposition 36 programs were approximately \$143 million.

HIV/AIDS Treatment and Prevention. Includes \$409.4 million for the AIDS Treatment and Prevention Program administered by the Office of AIDS, for an increase of \$24 million above the FY 2005-06 Budget. Of this amount, \$296.4 million is included in the AIDS Drug Assistance Program (ADAP) which provides life-saving medications to low-income persons living with HIV/AIDS.

Mental Health

Proposition 63. Includes \$8.4 million from Proposition 63, the Mental Health Services Act, for the State's implementation of the Act in FY 2006-07. Funding available for counties from Proposition 63 is \$648.9 million in FY 2005-06 and \$655.5 million in FY 2006-07.

AB 3632. Provides \$100 million in special education funding in the Department of Education budget for mental health services to special education pupils as required by the Federal Individuals with Disabilities Education Act. This includes \$69 million in Federal funds for counties to provide these services under contract with local education agencies and \$31 million in Proposition 98 funds for local

education agencies for pre-referral mental health services. The Administration has begun to consult with mental health and education stakeholders to shift AB 3632 from a State-mandated program to a categorical program in FY 2006-07. The Proposed Budget includes \$50 million as a set-aside in the Commission on State Mandates for funding mental health services to pupils under the new categorical program.

Social Services

CalWORKs Administration. Reduces the County Single Allocation for CalWORKs by \$40 million. The proposal allows counties to backfill the reduction with previously earned and allocated, but unspent performance incentive funds. Los Angeles County has spent all earned and allocated performance incentive funds. The Proposed Budget also proposes the use of \$40 million in savings in Federal TANF funds to offset State General Fund costs in Child Welfare Services and Foster Care.

CalWORKs Pay for Performance Allocation. Delays incentive payments to counties for the Pay for Performance Program pending full implementation of the "work first" and core work requirements for a savings of \$30 million in FY 2006-07.

CalWORKs Child Care. Reduces the FY 2005-06 allocation by \$114.6 million and the child care reserve by \$5.4 million which reflects lower numbers of CalWORKs participants moving into work and lower child care expenditures. It also retains \$11.5 million in the FY 2005-06 TANF reserve which will be available to counties if they incur additional child care costs.

Prospective Budgeting. Reduces CalWORKs administrative savings associated with prospective budgeting from \$127.7 million to \$102.7 million in FY 2006-07.

Statewide Fingerprint Imaging System. Proposes \$8.08 million for maintenance and operation, which is a \$57,000 increase.

Los Angeles Eligibility, Automated Determination, Evaluation and Reporting (LEADER) System. Includes \$11.4 million for maintenance and operation of the LEADER System which represents an \$842,000 increase and reflects estimated expenditures for the extension of the LEADER contract beginning in May 2007.

In-Home Supportive Services (IHSS). Proposes General Fund spending of \$1.3 billion in FY 2006-07, an increase of 4.1 percent over FY 2005-06 due to increased caseloads.

Supplemental Security Income/State Supplementary Payment (SSI/SSP) COLA. Withholds the January 2007 Federal COLA until July 1, 2008 for savings of \$48.1 million.

Foster Care. Increases funding for Child Welfare Services by \$89.1 million for a total allocation of \$3.8 billion.

Child Support Services. Proposes \$192.2 million in General Funds for local agency administrative costs; approximately the same level of funding provided in FY 2005-06.

Federal Child Support Automation Penalty. Proposes \$220 million in State funding for payment of the Federal Fiscal Year (FFY) 2006 penalty and assumes that there will be no penalty for FFY 2007 because the State and the Franchise Tax Board plan to submit a request for Federal certification of the California Child Support Automation System as an Alternate System Configuration, as required by the Federal government. Pursuant to Federal child support regulations, penalties will be held in abeyance while the Federal certification process is under review.

Justice and Public Safety

Booking Fee Subventions. Provides \$40 million to offset counties' costs to book suspects into county jails, but the Department of Finance indicates that this is a placeholder amount with actual funding to be determined with stakeholders.

Juvenile Probation Camp Funding. Provides about \$202 million from the General Fund for juvenile probation camps and comprehensive youth services. The Probation Department estimates that the County will continue receiving \$82 million.

Juvenile Justice Crime Prevention Act. Augments the Juvenile Justice Crime Prevention Act by \$73.9 million to restore the program to the \$100 million level for FY 2006-07, as prescribed by State statute.

Sexual Assault Felony Enforcement (SAFE). Includes \$6 million in local assistance grant funding in the Office of Emergency Services to support the activities of SAFE teams statewide. SAFE teams reduce violent sexual assault offenses through surveillance and arrest of habitual sexual offenders.

California Law Enforcement Telecommunications Systems (CLETS). Includes \$2.3 million to enhance and support CLETS which is a statewide telecommunications network available to all California law enforcement and criminal justice agencies.

Cost of State Parolee Violators. Provides \$85.1 million in FY 2005-06 and \$11.9 million in FY 2006-07 to reimburse local entities for the incarceration costs of parolees that are detained for State parole violations. Of this amount, \$55.4 million is set aside on a one-time basis to address outstanding prior claims for reimbursement. The remaining \$29.7 million for FY 2005-06 is to fund the anticipated shortfall in the current year. The Administration intends to pursue strategies that reduce the number of days these parole violators spend in local detention facilities.

New Judgeships. Includes \$5.5 million to support facilities, staff, salaries and benefits for up to 150 new judgeships phased in over a three-year period beginning in April 2007. The expenditure of these funds is restricted until legislation authorizing new judgeships is enacted.

Transportation

Proposition 42. Proposes to fully fund Proposition 42 at \$1.4 billion for FY 2006-07 and prepay a portion of the FY 2004-05 loan that is due to be repaid in FY 2007-08, which will provide an additional \$255 million to cities and counties. Counties can use this funding for street paving in the unincorporated areas. Also, the Budget proposes a constitutional amendment to permanently protect Proposition 42 funds and eliminate the option for future governors and legislatures to suspend the allocation.

Rail Safety. Proposes \$1.4 million to enhance rail safety through additional accident investigations, evaluations of quiet zone notices, railroad inspections, and oversight of rail transit agencies' homeland security programs.

Natural Resources and Environmental Protection

Water Projects. Proposes the sale of \$9 billion in General Obligation bonds for new water projects, of which \$6.5 billion will be dedicated to Integrated Regional Water Management for projects to improve drinking water quality and protect public health, complete surface water storage planning, develop water efficiency, and for research and development efforts that will address the energy requirements, costs, and environmental issues related to desalination.

Water Quality. Proposes an additional \$8.5 million to enhance existing water monitoring efforts.

Air Quality. Proposes \$2 billion for actions that will directly reduce air pollution resulting from the movement of goods and people, including \$1 billion for reducing current goods movement-related air pollution in and around major ports

and port-related facilities through cleanup and replacement of diesel engines in trucks and equipments.

Climate Change Initiative. Proposes \$7.2 million to implement greenhouse gas emission reduction strategies.

Alternative Fuels. Proposes \$500,000 to the Energy Resources Programs Account to implement AB 1007, which requires the development of recommendations to increase the use of alternative fuels.

Environmental Enforcement. Proposes \$6.2 million in special funds to strengthen environmental enforcement efforts, including: \$4 million to the Air Resources Board to enforce heavy-duty diesel regulations, evaluate on-board diagnostic systems in vehicles, and replace older testing and diagnostic equipment; \$1.5 million to the Department of Toxic Substances Control to enhance existing enforcement efforts related to the electronic waste recycling program; \$425,000 to the Department of Pesticide Regulation to conduct additional pesticide mill assessment audits; and \$223,000 to the Integrated Waste Management Board to investigate fraud in the electronic waste program.

Hydrogen Highways. Proposes \$6.5 million to the Air Resources Board to continue development of the Hydrogen Highway, which is part of the Governor's Hydrogen Highway Blueprint Plan that includes a goal of establishing 50 to 100 hydrogen fueling stations in California.

We will continue to keep you advised.

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